Background to Decontrols

Ontario

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SUMMARY

Wage Explosion

. In Canada, an unexpectedly virulent inflation in 1973, coupled with long-term labour agreements left workers with major catch-up wage demands. Much of these catch-up wage demands appear to have been accomplished by the end of 1976.

. In particular, the operation of the AIP has accommodated legitimate wage catch-up demands in the private sector.

. Rollbacks have represented only less than one percentage point on the average wage increase of workers subject to the guidelines. Since about half of the labour force is covered by controls, these rollbacks would not represent a significant potential, in aggregate, for a post-control wage explosion.

. Wage increases have shown a moderating trend in keeping with weakened market conditions, both international and domestic.

Labour Market Environment

. A significant shortening of labour contracts, re-opener clauses and the increased use of COLA clauses reflect labour's heightened sensitivity to unexpected inflation. This has significantly reduced the effectiveness of an expansionary monetary policy for short term employment gain.

. The increased use of COLA clauses suggests a potential for increased labour-management discord if future increases in the CPI emanate from price increases unreflected in producer price levels.

Open Economy

. Declining inflation in the goods sector has reflected the effect of international market pressures, but in the service sector and particularly the public sector, natural competitive pressures had a less restraining influence.

Public Sector

. The AIP clearly has had a more restraining effect on the public sector than the private sector. Public sector rollbacks under the AIP averaged 3.4 per cent compared to 1.7 per cent in the private sector.

Profits

. The effects of market restraint are evident in the fact that actual profit margins are well below allowable margins for the first year of the program. Actual profits of large firms are estimated to be $1.9 billion less than allowable profits; excess profits, on the other hand, have been only $13 million to date.

. Cyclical improvements in productivity could provide a non-inflationary basis for real increases in profits.

. Declining profits, increased costs of capital goods and excess capacity have contributed to a significant decline in real investment spending in 1976 and are important factors clouding the investment picture for 1977.

INTRODUCTION

The primary concern during the transition from the Anti-Inflation Program lies in the possibility of a post-controls wage-price "explosion", that would offset the beneficial effects of the program. This possibility depends on three important economic issues:

- How much did the control program restrain wage, price and profit increases during its operation;
- Will the post-control period provide an economic environment conducive to any wage-price explosion; and
- To what extent do market forces alleviate inflationary wage and profit demands in various sectors of the economy?

In terms of the first, the critical question will be how much of the improved price performance experienced under the AIP has been due to controls and how much to moderating price inflation in non-controlled areas such as agricultural commodities and industrial imports. On the wage side, the issue is the extent to which wage settlement rollbacks have curtailed legitimate catching-up demands, or, alternatively, the extent to which control targets have acted as a wage floor rather than a wage ceiling in contract negotiations.

The second issue deals with the likely state of demand in the economy in the post-controls period, and its possible impact on wage-price behaviour. This is primarily a question of the timing of decontrol. Part of this issue of timing will encompass

the nature of domestic monetary and fiscal policies prior to the lifting of controls. In addition, the state of foreign inflation at the time of decontrol will be a major factor.

The third issue deals with the extent to which the economy is subject to competitive pressures, particularly from international sources. Where competitive forces are weak or non-existent, the forces affecting income determination are less likely to restrain the tendency to overestimate potential future inflation.

POTENTIAL FOR WAGE EXPLOSION

The likelihood of a wage explosion is a major concern in the period of transition from controls. The experience with control programs in other jurisdictions (e.g., Britain and the United States) strongly suggests such a possibility. In these countries, it has been argued that income controls succeeded in supressing excessive wage demands, but once controls were lifted, "natural" economic forces led to the same, or almost the same, wage increases that would have ensued without controls. Many have predicted similar circumstances for the Canadian post-controls experience.

Wage Catch-up

International experience suggests that the imposition of controls will usually catch some groups in a relatively disadvantaged position. The removal of controls has resulted in an explosion of supressed demands, as these groups attempt to restore their economic position.

The Canadian experience, however, has been somewhat unique in this regard. Wage settlement trends in Canada leading up to the imposition of controls indicate that the wage catch-up process was already well under way, although not entirely complete.

CHANGES IN PRICES, OUTPUT & COMPENSATION IN MANUFACTURING: CANADA

Table 1

Year	Industry Selling Price	Compensation Per Manhour	Output Per Manhour
		(Per Cent)	
1966	2.3	7.8	2.9
1967	2.1	7.4	2.9
1968	2.3	7.6	7.3
1969	4.2	7.5	5.6
1970	0.7	7.8	1.7
1971	3.7	7.0	6.7
1972	5.7	7.2	3.2
1973	14.8	8.8	3.3
1974	20.0	12.3	-0.1
1975	6.7	16.4	1.6

Source: Department of Finance, Economic Review, April 1976 and Statistics Canada.

Table 1 illustrates the stability of wage settlements and prices since the mid-sixties and into the Seventies largely reflecting the effect of long-term labour agreements and a fairly modest and stable view of future inflation. Even in 1970, a year of business recession and declining profits, labour compensation continued to grow at around 7.5 per cent.

CHANGE IN PROFITS AND LABOUR INCOME RELATIVE TO OUTPUT, 1970-1976

Table 2

	Per Cent Change Per Unit of Output			
	Profits		Labour Income	
	Commercial	Manufacturing	Commercial	Manufacturing
1970	- 9.0	-21.5	5.2	6.1
1971	10.1	23.6	3.3	2.1
1972	16.9	15.5	5.3	3.3
1973	28.8	30.7	7.3	4.5
1974	19.3	28.4	12.7	11.8
1975	- 0.4	- 5.4	15.2	14.1
1976*	- 4.9	- 7.0	7.4	7.5

*Based on first three quarters of 1976.

Source: Bank of Canada Review

Beginning in 1973, a virulent international inflation fed by shortages of food and raw materials and crowned by a new monopoly price for oil, turned a potentially mild round of domestic price increases into rampant inflation. As a result of the existing contractual wage inertia, manufacturing price and productivity increases

considerably exceeded compensation gains to labour in both 1973 and 1974. Correspondingly, profits soared in this period. Table 2 shows that manufacturing profits per unit of output advanced by about thirty per cent annually in 1973 and 1974, while labour cost per unit of output rose by 4.6 and 11.8 per cent in the same period.

A combination of unexpected inflation and contractual rigidities had produced a circumstance ripe for wage explosion. Across the entire economy, those workers covered by existing contracts fell seriously behind those who were able to renegotiate in the new inflationary environment of 1973 and 1974. As long-term contracts came up for renegotiation, wage demands exploded reaching a peak in 1975. As is often typical of such wage cycles, the peak wage demands came at a time when the international forces of inflation were receding, and domestic manufacturing price increases were moderating considerably. These wage increases also were revealing of major competitive weaknesses that had already been building in the Canadian economy.

The critical issue, now, is whether the explosive wage demands which built up under existing contracts during the unexpected inflation of 1973 and 1974 were fully released in the 1975 and 1976 period. In particular, concern focuses around the effect of the AIP in continuing to bottle-up wage pressures in 1976.

The Anti-Inflation Program 1976

The Canadian Anti-Inflation Program, unlike that in other jurisdictions, provided for wage catch-up in excess of the guidelines for those workers who had been under long-term contractual agreements during the height of the inflation. The result is that much of the wage pressure that would have been bottled-up by a stricter application of guidelines has been released during the first year of controls.

As of December 3, 1976, the AIB had reviewed contracts covering approximately 3.0 million employees in both the public and private sectors. Almost 47 per cent of these had compensation increases that were below the first year guideline by an average of 1.5 percentage points. These settlements below the guidelines suggest that natural market pressures were sufficient to subdue wage increases of groups without "catch-up" demands.

CANADIAN WAGE SETTLEMENTS UNDER THE AIB
(To December 3, 1976)

Table 3

Settlement	Employees (#)	Average Increase (%)		
		Negotiated	Guideline	Approved
Below Guideline	1,393,491	8.7	10.2	--
Above Guideline	1,603,786	12.7	9.2	--
Decisions				
Private Sector	610,470	12.8	9.3	11.1
Public Sector	313,433	15.0	9.8	11.6

Source: Anti-Inflation Board

Table 3 shows that, of the group that settled above the guidelines, slightly over 66 per cent was in the private sector. The average proposed increase in this private sector group ruled on by the AIB, was 12.8 per cent, and the approved increases averaged 11.1 per cent, for an average rollback of 1.7 per cent. If all private and public sector rollbacks are set in relation to all settlements under the AIB, then the average rollback was only 0.9 percentage points. The over-all impact of rollbacks has therefore, been relatively modest; and the possibility of a post-control wage explosion that is, in aggregate, significant seems limited. This is not to discount the likelihood of some specific instances of post-control "catch-up".

Average hourly earnings in manufacturing advanced at an annual rate of 11.1 per cent over the first 9 months of 1976 following an average increase of 13.5 per cent in 1975. This compares with industry selling price increases of only 3.6 per cent and 6.7 per cent in the same periods. In addition, there has been a moderating trend in wage settlements reviewed by the AIB. Labour, in the private industrial sector, seems to have re-established much of the ground lost in the unexpected inflation of 1973 and 1974. If so, settlements may continue to reflect this significantly moderating trend.

Current Labour Market Environment

The current labour environment in Canada is significantly different from that which prevailed in 1970. The inflation of 1973-1974 has sensitized workers and their leaders to the prospects of inflation. This sensitivity has manifested itself in a number of important ways.

Faced with rapidly changing rates of inflation both management and labour, have shown increasing reluctance to enter into long-term contractual arrangements. In 1975 and 1976, about half of all collective agreements negotiated in Canada were for a duration of one year, compared with a 14 per cent of all agreements in 1973. A similar situation is depicted for Ontario in Table 4.

DURATION OF COLLECTIVE BARGAINING AGREEMENTS:
CANADA & ONTARIO, 1970-1976

Table 4

	Share of Collective Agreements			
	Canada		Ontario	
	1 year	3 years & over	1 year	3 years & over
	(Per Cent)			
1970	14.2	31.8	N.A.	N.A.
1971	18.2	32.6	16.0	29.0
1972	17.6	30.9	15.6	26.9
1973	13.8	30.8	7.6	20.4
1974	27.3	13.3	15.9	14.6
1975	47.0	10.9	39.7	12.1
1976	51.9	20.0	44.5	10.2

Source: Economic Council of Canada, Thirteenth Annual Review and Ontario Ministry of Labour.

Unlike 1973 and 1974, labour is now in a position to react very rapidly to changes in prices. Consequently, it will be some time before wage negotiations will exhibit the inertia shown in earlier periods. The implications of this are serious, particularly for monetary policy in the post-control period. To the extent that large increases in the money supply are quickly translated into price increases, they will be as quickly translated into wage increases. Therefore, the short-term employment gains which sometimes can be achieved through expansive monetary policy will be less available in this kind of labour market environment, making inflation an immediate consequence of such a policy.

Wage negotiations in Canada, and particularly in Ontario, have shown an increasing tendency on the part of labour to protect real wages through the use of cost of living adjustment clauses. Table 5 illustrates the growing use of COLA brought about by the recent inflation experience. In 1975, 50 per cent of the agreements in in the private sector contained a COLA clause. While the private sector has shown a greater tendency to use this contractual arrangement, the provincial, municipal and semi-public sectors have recently exhibited a growing demand for this form of inflation protection.

PROPORTION OF MAJOR COLLECTIVE AGREEMENTS CONTAINING COLA CLAUSES, 1971-75

Table 5

	1971	1972	1973	1974	1975
			(Per Cent)		
Private Sector	6.0	13.6	23.6	40.5	50.4
Manufacturing	9.2	16.9	31.0	45.5	56.3
Public Sector	0.0	7.4	9.5	17.7	20.3
Federal	0.0	0.0	0.0	1.8	1.8
Provincial	0.0	14.0	17.0	29.0	25.0
Semi-public	0.0	5.9	8.4	15.3	16.3
Municipal	0.0	0.0	0.0	2.0	11.0
TOTAL	4.4	11.8	19.4	33.7	41.0

Source: Economic Council of Canada, Thirteenth Annual Review.

COLA protection clauses are often traded off against the acceptance of longer term contracts. For example in Ontario, in 1975, of the 345 collective agreements signed without a COLA clause, only 7 were for 3 years or longer. In the same year, of the 140 agreements with COLA clauses, 51 were for a 3-year term.

The increasing focus of labour negotiations on real wages as measured by price indexes such as the Consumer Price Index is not an entirely favourable event. The danger is that consumer price indices can respond to changes in commodity prices requiring real income transfers from one group to another, without a corresponding change in most private producer prices. Therefore, the trend to tie wage increases to the Consumer Price Index has resulted in some problems:

. Since producers may have no increased ability to pay but workers are determined to recapture any loss in their real wages, there may be increased labour-management discord.

. Attempts by government to shift real income from the private to the public sector by prices or taxes which impact on the CPI may simply be translated into wage increases and price inflation.

. Some price increases reflect real shifts in the distribution of income, either internationally or domestically, as a result of scarcities in strategic raw commodities (e.g., oil). If these result in automatic wage increases, it may shift the burden from those able to protect themselves to those who are not.

The new labour environment in Canada has a number of advantages for the post-control period. The new flexibility in labour contracts such as shorter contracts and re-opener clauses, will avoid building in long-term labour cost increases regardless of the rate of inflation, and it may help break the catch-up cycle when demand is falling off. Furthermore, it will increase the restraint on a premature attempt to raise prices in order to improve profit margins.

The experience of the recent inflation also demonstrates that considerable gain can be made through policies to encourage increased contractual flexibility in the face of unusual circumstances. In Ontario and Canada, the growing number of strikes and lockouts through the 1970's is, in part, a result of unanticipated and rapidly changing rates of foreign and domestic inflation. The uncertainty, risks and losses resulting from contractual rigidities during this period contributed not only to industrial unrest, but in

the end to both growing unemployment and added inflation. Table 6 illustrates the growing industrial unrest during the period 1970-1975, with the number of strikes and lockouts in 1974 and 1975 reaching twice the level of 1972, and placing Canada in an unenviable position by international comparisons.

STRIKES AND LOCKOUTS IN ONTARIO, 1970-1975 Table 6

Year	Strikes & Lockouts Beginning During Year
1970	202
1971	193
1972	170
1973	191
1974	329
1975	336

Source: Labour Canada, 1976.

EXTERNAL ENVIRONMENT

Canada is extremely open to international economic influence. Not only does Canada import some 27 per cent of total Gross National Expenditure, but also most prices of Canadian exports are determined in world markets. In total, imports and exports account for about 50 per cent of total GNE. Similarly, the prices of many domestically produced, import-competing goods are determined by international prices. Together, these factors indicate a profound impact on the Canadian economy from foreign sources. While all sectors experience international cost pressures, in a competitive sense this influence is felt primarily in the private goods-producing sector. On the other hand, many parts of the domestic service industry, including the public and quasi-public sectors, while affected somewhat by internationally determined costs, do not feel the direct restraint of international competition.

The international inflation which gathered momentum in 1972 and continued until 1975 was unprecedented in post World War II history. As shown in Table 7, in 1972 farm and raw materials prices led off the sudden break from previous patterns. Manufacturing prices, which had been rising to restore profit margins from the recession of 1970, were spurred on to grow at an even greater rate. That these events were also largely an international phenomenon is indicated by the large increases recorded in both export and import prices during the period 1973 and 1974. Despite

SELECTED PRICE AND WAGE CHANGES, 1965-1975

Table 7

Year	Farm Prices	Thirty Industrial Materials Prices	Industry Selling Prices	Export Prices	Import Prices	Consumer Prices	Average Hourly Earnings in Manufacturing
				(Per Cent)			
1965	6.4	0.2	2.6	1.5	1.2	2.4	5.0
1966	8.5	1.0	2.3	2.9	2.6	3.7	6.1
1967	-0.9	-3.2	2.1	1.0	1.1	3.6	6.7
1968	-1.7	0.4	2.3	1.2	4.0	4.0	7.5
1969	2.5	5.4	4.2	2.6	2.9	4.6	8.1
1970	-0.7	0.4	0.7	3.4	1.3	3.3	7.9
1971	1.0	-0.7	3.7	1.2	3.0	2.9	9.0
1972	13.4	12.2	5.7	4.9	3.4	4.8	7.9
1973	44.3	30.5	14.8	19.7	11.1	7.5	9.0
1974	19.4	26.8	20.0	27.4	25.5	10.9	13.2
1975	-0.4	-2.0	6.7	6.9	5.9	10.8	15.8
1976* (9 months)	-9.8	3.8	3.6	2.2	1.7	7.3	11.1

Source: Statistics Canada and Bank of Canada.

rising prices and incomes, real output gains in the goods producing sector were small and hampered the absorption of a rapidly growing labour force.

By 1975, however, there was growing evidence that international inflation had begun to recede. Furthermore, prices of farm and raw materials were actually declining. Canadian goods producers were facing stiffer international competition both at home and abroad, resulting in a December over December increase in industry selling prices of only 6.7 per cent in 1975 following a 20.0 per cent increase in 1974. Although unpredicted, these trends continued in 1976.

This reduction in international price pressure, coupled with declining farm gate prices in 1976 combined to produce an increase in the CPI below that predicted for 1976. It should be noted that none of these factors were under the direct control of the AIP. Rather, any moderation in prices in the export, import, agricultural and raw materials sectors came about primarily through the operation of international market forces.

Despite the moderating effects evident from international sources as early as 1975, domestic inflation had begun to gain momentum. Consumer prices continued to advance rapidly in 1975, despite the moderation in producer prices. Those areas of the economy, primarily the public sector, but also parts of the private service sector not subject to international competition,

were beginning to make enormous demands on the basis of an anticipated, ever-accelerating rate of inflation. The potential for an even more damaging, domestically-inspired inflation was clearly evident.

The goods sector is more open to international inflationary pressures, while price increases in the service sector generally reflect domestic sources of inflation. As shown in Table 8, after reaching a peak in 1974, inflation in the goods sector of the CPI began to show moderating increases, particularly in 1976, in line with declining international rates of inflation. The price increases in the service sector peaked in 1975 and showed only a marginal moderation in 1976, indicating that a more domestically-inspired inflation had taken hold.

GOODS SECTOR AND SERVICE SECTOR PRICES: ANNUAL PERCENTAGE CHANGE* — Table 8

Year	Consumer Price Index	
	Goods	Services
	(Per Cent)	
1972	2.4	2.2
1973	8.7	5.6
1974	13.9	9.7
1975	8.2	11.9
1976	2.8	11.1

*December to December percentage changes.

Source: Statistics Canada.

PUBLIC SECTOR

Among the sectors of the Canadian economy that are influenced by international cost factors, but not directly constrained by international competition is the public sector. This presents a different dimension to the inflation problem.

The data shown in Table 9 indicate that wage and salary increases in public administration fell behind those in the private sector from 1971 to 1973. However, public employees made major catch-up gains, particularly in 1975. In the supplementary benefits category, public sector employees achieved especially large increases.

Under the AIP, this pattern of public employee income increases continued into 1976. Table 10 shows public sector wage settlements ruled on by the AIB were in excess of private sector settlements by about 2.2 percentage points. Public sector rollbacks have averaged 3.4 per cent compared to 1.7 per cent in the private sector, suggesting that wage demand pressure continues to be strong in this sector. Nonetheless, public sector settlements have shown considerable moderation since the spring of 1976 when they were averaging in excess of twenty per cent.

Table 9

ANNUAL CHANGE IN WAGES AND SALARIES AND IN SUPPLEMENTARY LABOUR INCOME PER PERSON EMPLOYED BY MAJOR SECTOR, 1971-1975

Year	Private Sector		Public Administration		Total	
	Wages & Salaries	Supplementary Labour Income	Wages & Salaries	Supplementary Labour Income	Wages & Salaries	Supplementary Labour Income
			(Per Cent)			
1971	7.0	14.9	8.2	9.1	7.2	14.4
1972	8.0	15.7	7.2	13.6	7.9	15.6
1973	9.5	15.2	7.2	9.9	9.3	14.5
1974	12.7	20.5	15.2	23.8	12.9	21.0
1975	12.3	19.6	15.8	29.1	12.7	21.1

Source: Economic Council of Canada, Thirteenth Annual Review.

CANADA WAGE SETTLEMENTS IN EXCESS OF GUIDELINES
RULED ON BY AIB (To December 3, 1976)

Table 10

Settlement	Employees (#)	Average Increase Negotiated (%)	Guideline (%)	Approved (%)
Public Sector	313,433	15.0	9.8	11.6
Private Sector	610,470	12.8	9.3	11.1
TOTAL	923,903	13.6	9.5	11.3

Source: Anti-Inflation Board

A similar situation exists for the public sector settlements in Ontario. The average rollback in the public sector was 3.5 per cent compared to 1.3 per cent in the private sector. Again, based on this analysis, the Ontario public sector may be expected to express greater relative wage demands in the post controls period.

Indications are that wage settlements and price increases, in much of the private sector have begun to moderate under market pressures. On the other hand, the public sector, where market restraints are somewhat weaker, has been brought under stricter control by the Anti-Inflation Program.

PROFIT PERFORMANCE

The restraining influence on profits from weaker markets and stiffer foreign competition on the one hand and rising costs on the other, is illustrated in Table 11. Profits fell in 1975 and continued their downward trend in 1976. Of course, in many industries the decline was from the very high and unsustainable levels achieved in the 1973-1974 period. Nonetheless, the profit performance in 1976 has not been strong, particularly when the impact of inflation on capital replacement costs is considered.

CORPORATE PROFITS, CANADA, 1975-1976
($ MILLIONS, SEASONALLY ADJUSTED ANNUAL RATES) Table 11

	1975	1976:1	1976:2	1976:3
Pre-Tax Profits	18,587	18,604	18,704	18,516
Growth (%)	-1.1	-17.6	2.2	-4.0
Pre-Tax Profits with IVA*	15,722	16,436	16,760	16,976
Growth (%)	8.1	-15.0	8.1	5.3
After Tax Profits	11,437	11,468	11,624	11,132
Growth (%)	-3.9	-21.0	5.6	-15.9
Pre-Tax Profit Margins(%)**	7.1	6.4	6.4	6.2
After-Tax Profit Margins (%)**	4.2	3.8	3.8	3.7

*By adjusting for inventory profits or losses, this item measures "operating profits from current production".

**For the sum of five industry groups: mining, manufacturing, transportation, trade and services.

Source: Statistics Canada.

The restraining effect of weak markets and tough import competition as opposed to price and profit controls is indicated by the performance of profit margins in the first compliance period. In its report on the first year of controls, the Anti-Inflation Board reports a significant gap between allowable profit margins and the actual margin achieved by firms subject to the guidelines.

PROFIT MARGINS OF FIRMS REPORTING TO AIB

Table 12

	Reporting Group		
	Distribution	Unit Cost	Net Margin
Number of Firms	658	385	1,337
Base Period Margin (%)	4.85	10.08	8.82
First Compliance Year Margin (%)	4.09	9.11	6.02

Source: Anti-Inflation Board, First Year Report.

It is estimated that large firms under the AIP achieved profits in the first compliance period about $1.9 billion below allowable levels. Excess revenues, earned by firms reporting profit margins above target margins, amounted to only $13 million in the same period. Clearly, the impact of natural market forces has tended to provide greater restraint on prices and profits than the AIP.

In general, the impact of profit control on aggregate price restraint will be minimal since pre-tax profits represent only

about 11.5 per cent of GNP. The danger exists, however, that premature attempts to restore profit margins will represent the signal for increased income demands in all sectors of the economy. This places a crucial emphasis on cyclical productivity improvement.

The potential for an improvement in returns to both capital and labour, without inflationary impact, from an increased utilization of capacity are significant. In Canada's manufacturing sector, for example, as Table 13 shows, excess capacity in the third quarter of 1976 stood at about 17 per cent.

CAPACITY UTILIZATION RATES IN MANUFACTURING: CANADA — Table 13

Year end Quarter	Total Manufacturing Utilization Rate (Per Cent)
1974	89.8
1975	82.0
1976 I	82.3
II	84.1
III	83.3

Source: Statistics Canada

A danger of continued profit control is that, as the economy strengthens, neither profits nor wages will be allowed to share fully in the cyclical productivity increases, although such increases could provide for both profit and wage gains without

further price hikes. The removal of controls might be followed by attempts to recapture a full share in productivity advances, resulting in rising prices. The added disadvantage, is that such price increases would give the appearance of a continued need for detailed control of the economy. Furthermore, any price increases would be quickly registered in wage increases in the highly sensitized labour market environment. Monetary policy would again face the immediate dilemma of accommodating these demands or creating more unemployment.

Sharp increases in equipment costs, lower profits, excess capacity and major economic and political uncertainties have all contributed to the poor investment performance recorded during the past year. Particularly for plant and equipment, there has been a pronounced decline in real spending by businesses. There are, as well, growing signs of weakness in non-residential construction expenditures. These declines are indicative of the present disheartening prospect for future investment plans. The challenge is to restore a stable, profitable basis for investment, if it is to recover and to provide the long-run productive capacity required for a non-inflationary growth in real output.

CONCLUSION

When controls should end is as important as how they should end. The best example of poor timing for the end of a controls program is the American experience in 1973 and 1974. The United States full control program came to an end at the outbreak of the international inflation in 1973. After attempting a reimposition of full control in 1974, the entire program was finally abandoned late in the same year. Even the much less open American economy could not control the international inflationary pressures that were generated in those years. The lesson for the Canadian experiment is to end controls once domestic pressures have begun to recede, and before any renewed price pressures in the international economy.

A second important aspect of timing for decontrol is that it should occur when consumer price movements are in phase with those of manufacturing selling prices. This will be important if we are to achieve a reduction in tension in already volatile labour-management relations. Furthermore, it will be essential if the productivity increases that will follow for both real wage and profit gains, without inflationary pressure, are to be realized. Only in a period of relative industrial harmony can the Canadian economy hope to restore the conditions for improved competitive performance and increased investment.

The question of decontrol has become intimately mixed with concern over policies to reduce the high levels of unemployment. In this regard, it should be noted that Canada's unemployment problems have important regional and demographic characteristics. These characteristics are central to the inflation-unemployment policy conundrum perplexing many Western governments in the 1970's. For example, new entrants to the labour force, particularly the young have low productivity and, given nominal wage rigidities, there must be significant inflation in the domestic sector of the economy before the real wage of these workers is reduced to the point where they can be employed.

The "tightness" of the labour market is not well measured through the national unemployment rate. Additional considerations on the age structure and geographic nature of unemployment are also essential. In addition, unemployment that is arising from unassimilated new entrants to the labour force has a less depressing effect on wage demands than unemployment created by the lay-off of existing workers. Therefore, if in conjunction with decontrol, general demand stimulation is used to augment domestic demand, then it is unlikely to be successful except at the expense of further inflation. As already noted, this is particularly true of monetary policy in a period when organized labour can react quickly to any price increases. In these circumstances, employment policies during decontrol may have to be more "structural" in conception and implementation.

Most economists argue that competition is far more effective and all-encompassing than is sometimes popularly alleged. For Canada, international competition is often the primary force. Evidence of this is found in the declining competitiveness of Canadian goods and in the moderating effect that a decelerating international inflation has had on domestic manufacturing prices. The international marketplace continues to be an effective mechanism for restraining inflationary excesses, and present indications are that restraint will mark the general pace of worldwide recovery.

The role played by the public sector in accelerating the domestic aspects of the recent inflation continue to be a matter of concern, however. The issue is not related solely to wage settlements in the public sector but also to income demands in those areas of the economy which indirectly receive public sector funding. These areas of the economy, while subject to competition in the bidding for resources, are often not subject to competition on the demand side in their provision of services. Without automatic market criteria to guide income demands in activities directly provided or funded by the public sector, the stampeding psychology of rampant inflation is even less constrained. The Anti-Inflation Program clearly has had a beneficial effect in moderating expectations and anxieties in this sector.

The AIP in Canada has had its place in reducing public hysteria at a time when major decisions about the future of the

Canadian economy had to be made. But controls are not and cannot be the solution to the restoration of growth and competitiveness in the Canadian economy. The most permanent and satisfying anti-inflation policy of all is a positive and aggressive approach to the improvement of Canadian productivity in all areas of economic activity. In a market economy, this end is best served by a policy to promote the free operation of markets and the growth of capital.